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SENSITIVE
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SUBJECT: MACEDONIA'S 2009 BUDGET: SEEKING FISCAL STIMULUS VIA HIGHER
CAPITAL INVESTMENTS

SENSITIVE BUT UNCLASSIFIED - PLEASE PROTECT ACCORDINGLY

Summary

¶1. (SBU) On December 29, the Macedonian Parliament passed the country's largest budget since independence, projecting a general government deficit of 2.8 percent of GDP. With this budget, the GoM continues to implement a fiscal program characterized by low and flat tax rates with increased public investments in railways, road, and energy infrastructure, in an effort to respond to possible effects of the global financial crisis. However, the fiscal stimulus likely will not be enough to counteract effects of the crisis, particularly if the GoM does not proceed with important structural reforms in key areas to improve the business climate and provide security for investors. End Summary.

Fiscal Stimulus for Faster Growth

¶2. (U) The Macedonian Parliament passed the 2009 budget on December 29, after four days of debate. Minister of Finance Trajko Slaveski characterized the fiscal policy in 2009 as consistent and coordinated with GOM monetary policy aimed at securing stability of the Macedonian denar, which is pegged to the Euro, and expansionary in infrastructure investments in response to possible effects of the global financial crisis and ensuing economic slowdown. According to Slaveski, the budget will enable (and assumes) GDP growth of 5.5 percent in 2009, and will increase employment.

Relaxation of Fiscal Policy

¶3. (U) In 2009, the GoM will loosen fiscal policy, increasing spending and projecting a general government deficit (the deficit of the central government plus the state pension, employment, health and road funds) of 2.8 percent of GDP. The central government deficit in 2009 is projected to run USD 225 million, or 2.4 percent of GDP. The increased deficit spending also represents a break with IMF recommendations, which the GoM saw as too conservative and hindering faster growth. Macedonia did not renew its arrangement with the IMF after the expiration of the Stand-By Arrangement in August 2008, and Minister of Finance Slaveski publicly repudiated the subsequent IMF Article IV Review that urged tighter spending.

The Largest Budget So Far

¶4. (U) The GoM expects to collect revenues of USD 3.4 billion (Note: The budget is presented in Macedonian denars. Exchange rate used for all calculations: 1 USD = 45 denars), 5.8 percent more than the revised 2008 budget. Revenues in the central government budget are expected to reach USD 2.5 billion, 8.3 percent more than the revised 2008 budget.

Central Government Revenues in millions of USD:

	2008	2009	2009

Type of tax	actual	projected	pct. of total
Personal income tax	193	230	9.2
Profit tax	191	231	9.3
VAT	804	947	38.0
Excise	301	322	12.9
Import duties	139	155	6.2
Non-tax revenues	347	463	18.6
Other revenues	128	142	5.8

Reduction of Social Contributions

¶5. (U) As a continuation of tax reform policies begun in 2007, the GoM decided to reduce social contributions beginning January 1, ¶2009. Contributions to the Pension Fund will decrease from 21.2 percent to 19 percent of gross wage, payments to the Health Fund from 9.2 percent to 7.5 percent, and to the Employment Agency from 1.6 percent to 1.4 percent. Further gradual reduction of contributions will continue in 2010 and 2011. Collection of all social contributions and the personal income tax will be centralized in the Public Revenues Office, and calculated on a single tax base. Further reduction of the average customs duty will continue in 2009, as an obligation of WTO membership. The Customs Administration is expected to collect about half of all budget revenues in 2009, as was the case in 2008.

Expenditures

¶6. (U) The GoM projects 2009 general government expenditures to be USD 3.7 billion, 9.6 percent higher than in 2008. Current expenditure will dominate with 82.5 percent of the total. The GoM will expand capital spending by 7.1 percent compared to 2008. Expenditures in the central government budget are projected at USD 2.7 billion, which is a 15.5 percent increase from the 2008 budget

as revised in July.

Central Government Expenditures in millions of USD:

	2008	2009	2009
Expenditures	actual	projected	pct. of total
Wages and allowances	449	541	19.9
Goods and services	368	465	17.1
Transfers	854	1,052	38.7
Interest	58	69	2.5
Capital expenditures	408	584	21.5
Other expenditures	12	8	0.3

Transfers Growing by 27.4 Percent

¶7. (U) The single largest item on the expenditures' side is transfers, growing by notable 27.4 percent in 2009. About 45 percent of all transfers will go to the extrabudgetary funds (Pension Fund, Health Insurance Fund and Employment Agency), to cover for regular adjustment of pensions, past losses, and current losses due to lowered contributions' rates. Current transfers to units of local government will absorb 26 percent of all transfers, and 90.6 percent of them will be spent for firefighting brigades, as a new responsibility transferred to local governments in 2008. About 20 percent of all transfers the GoM will use for subsidies, out of which USD 174 million is in agriculture, and about USD 20 million for Macedonian National Television. The rest of the transfers in the amount of USD 97 million will go to social assistance programs.

Wages, Allowances, Goods, Services, Also Going Up

¶8. (U) Wages and allowances in 2009 are projected to grow by 9.7 percent to account for the promised 10 percent wage increase in public administration and for some new hiring necessary for equitable representation of minorities and mandated by the 2001 Ohrid Framework Agreement (FWA). In particular, the Secretariat for Implementing the FWA, established in 2007, will increase its budget in 2009 by 70.5 percent. The GoM increased spending for goods and services by 5.6 percent in 2009, incorporating in this item the costs for the local and presidential elections, GoM's programs for free goods and services, especially in education and health, as well

as expenditures for the GoM's marketing commercials.

Capital Spending, a Cure Against Crisis

¶9. (U) The GoM in 2009 is focusing heavily on capital investments as a way to alleviate possible effects of the global economic slowdown. The budget allocates USD 584 million, 9.5 percent more than in the revised 2008 budget. Some of the major projects mentioned include road and railways infrastructure investments in Corridor X and Corridor VIII, investment in a ski-center near the border with Greece, reconstruction of schools, building sports halls, new university facilities in Stip, completion of upgrades to the Skopje City Stadium, building low-cost and subsidized apartments, as well as investments in water irrigation and sewage systems, in information technology projects, and in environment. The GoM will continue promoting the country abroad, trying to attract foreign investors, for which it allocated USD 6 million to the Agency for Foreign Investments.

Higher Budget for Important Programs

¶10. (U) Through the 2009 budget, the GoM has signaled that it intends to pursue important structural reforms, while increasing spending for several specific government programs. Most notably, it raised the Ministry of Justice's budget for judicial reform from USD 7.2 million in 2008 to USD 11.4 million in 2009. The GoM increased the Ministry of Defense's budget from USD 154 million in 2008 (1.8 percent of GDP) to USD 185 million in 2009 (2.0 percent of GDP.) Also, in accord with its EU membership aspirations, it raised the budget of the Secretariat for EU Affairs by 250 percent, to USD 14.7 million.

Financing the Deficit

¶11. (U) The projected 2009 budget deficit will be primarily financed by domestic and foreign borrowing. The GoM expects to borrow USD 133 million from the domestic market by selling government paper, and USD 111 million from the foreign market, including USD 20 million from World Bank's Second Programmatic Development Policy Loan (PDPL 2). In addition, the GoM is planning to withdraw about USD 89 million from its deposits with the National Bank of Macedonia. Regular payments on its domestic and foreign debt will cost the budget USD 163 million in 2009.

Comment

¶12. (SBU) The GoM based 2009 budget projections on a rather optimistic scenario of 5.5 percent GDP growth. This contrasts with the National Bank's growth projection, which ranges from 3 to 4.5 percent. Results in Q4 of 2008 in several industries have shown that effects of the global economic slowdown have damaged their 2009 growth prospects, manifested in particular by slowed foreign direct investment. Considering that revenues from some of those industries -- such as metallurgy and ferrous metals -- are large contributors to the state budget, the GoM will face serious challenges staying within the already loosened 2.8 percent deficit. The GoM needs to continue structural reforms which will improve the business climate, while respecting the rule of law, property ownership, and contract enforcement. In addition, fiscal stimulus through increased capital expenditures will fail if the GoM continues poor budget management throughout the year, and especially if it does not conscientiously spend allocated funds for efficient capital projects. End comment.

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